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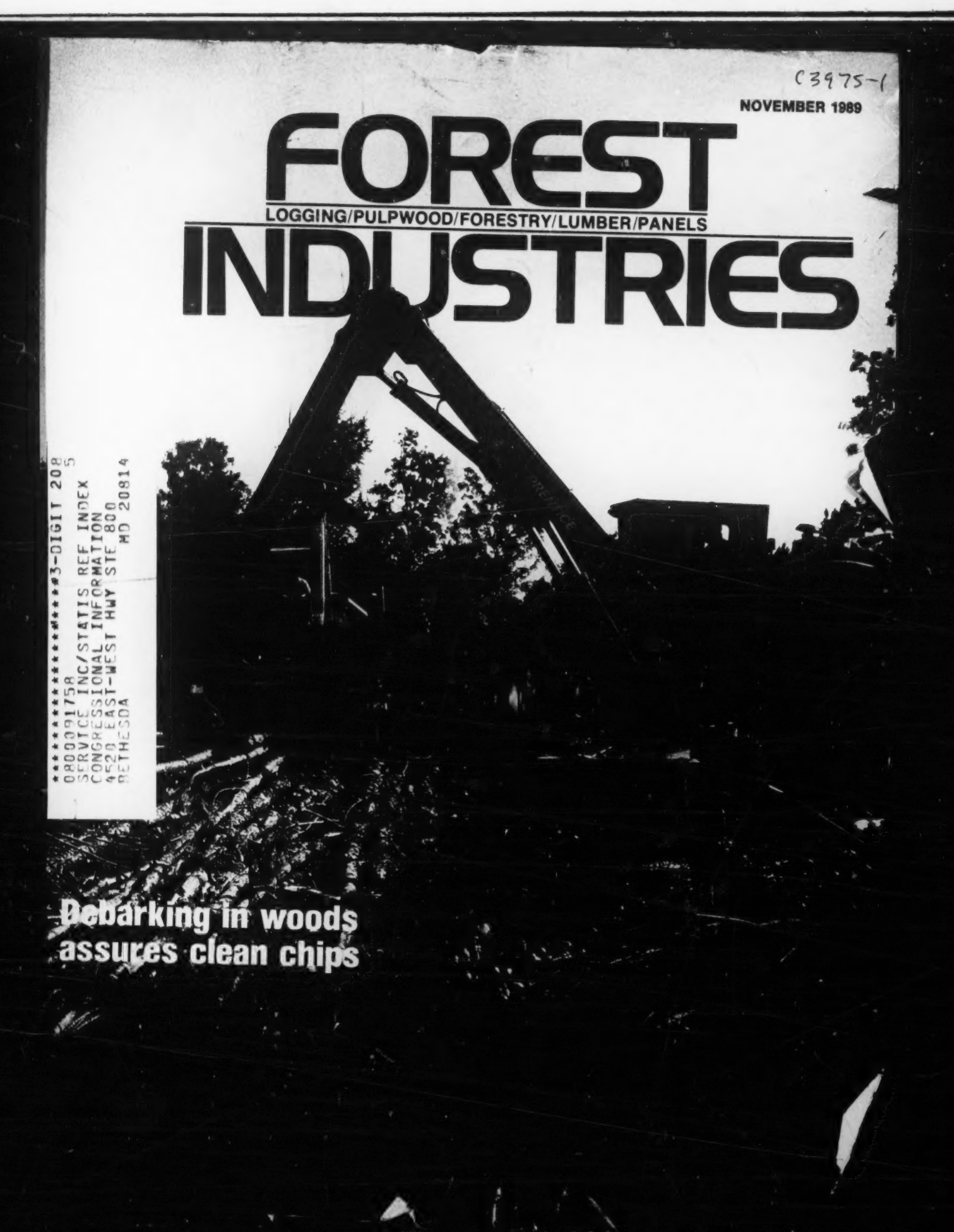

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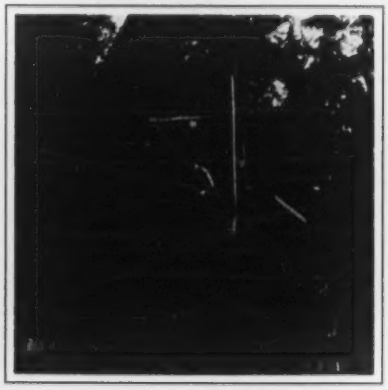

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The 1980s 'mega-trend' has been rapid globalization of markets for pulp and paper products, with raw wood fiber markets following suit. What does the next decade hold?

Changes in regional supplies to boost world fiber trade

By Robert W. Hagler

Reston, Virginia

The world will become a busier place for shippers of wood fiber during the 1990s as changes in regional supplies of wood lead to expanded opportunities for imports and exports.

In the 1980s, perhaps the greatest single "mega-trend" impacting the forest industry was rapid globalization of pulp and paper markets. The acceptance of eucalyptus and other hardwoods, increasing use of intensively managed plantation fiber and competitive ocean freight rates during the '80s have broadened the spectrum of competition.

A pulp mill in Georgia still competes with its Alabama neighbor, but also with mills in Sweden, Portugal, Brazil, Chile and New Zealand. Booming pulp markets have strained some local resources and forced markets to become more world-oriented.

Can forest resources keep up with the demand? Are we running out of wood?

The answer, of course, is no. In most regions of the world, a slight increase in domestic wood prices has a dramatic effect on the volume of wood available for industrial uses. Global shortages of industrial wood are not anticipated over the next 10-20 years.

However, we do seem to be heading for regional dislocations in wood supply. They will affect both the relative cost of wood fiber and corporate management and investment strategies during the next decade.

Supply imbalances are developing in both softwoods and hardwoods.

Among softwood producers, the imbalance favors several Pacific Rim nations (Fig. 1). Projected surpluses of conifers in Chile, Australia and New Zealand could dramatically change the competitive positions of these regions compared to traditional suppliers to Japan, Taiwan and Korea. Tightening supplies in the U.S. Pacific Northwest will accelerate the process.

Wood costs will favor Chile and New Zealand, especially, as compared to other softwood sources.

Around the Atlantic Rim, softwood supplies will be extremely tight. Northern Europe's forests are intensively managed; eastern Canada's are currently fully utilized on a sustained-yield basis. These wood supplies are not very responsive to supply and demand pressures. The exceptions are the privately owned woodlands of the eastern U.S.

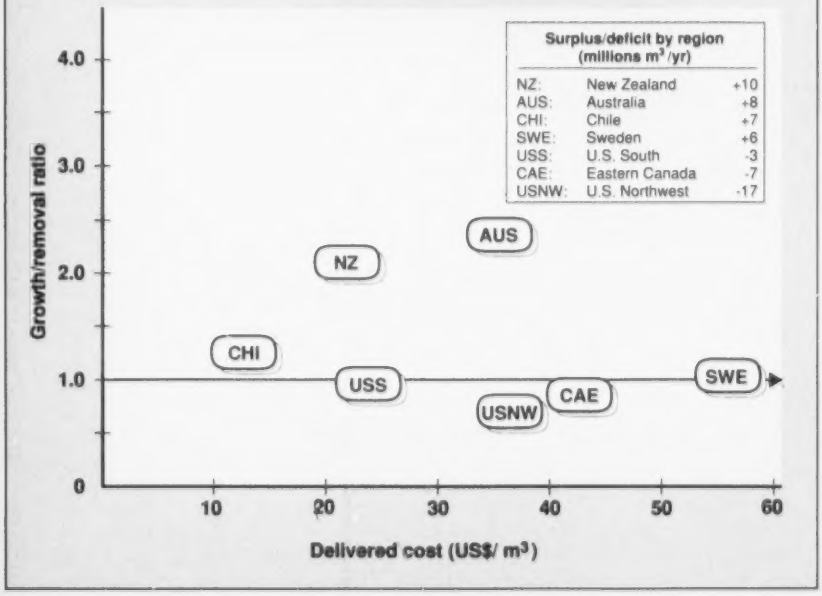
As Fig. 2 shows, the Atlantic Rim boasts large hardwood supplies. The overgrowth from the U.S. South and eastern Canada alone equals the combined surpluses of Chile, Australia and the U.S. Pacific Northwest. Brazil, Central America and Africa also have large supplies of available hardwoods.

This brief snapshot analysis covers regions which represent the trend toward dislocation in world fiber resources. This growing dislocation has already impacted world trade and wood prices. Over the next decade, it will be a driving force behind the strategic positioning of major industry participants attempting to capitalize on, or negate, competitive advantages resulting from wood fiber dislocations.

Domestic markets for pulpwood and wood chips are affected by three factors: supply/demand, production costs and export/import opportunities. Until the 1980s, most North American markets were driven by either supply/demand or production costs—especially in the U.S. South and Ontario.

Because of landownership patterns and a diminishing dealer system, the South is almost a totally open market for pulpwood. Prices can rise above production cost increases, or fall in both real and nominal terms. Prices determine supply; deficit cutting (growth/removal ratio less than 1.0) is unrestrict-

FIG. 1—Softwood fiber supply environments for selected regions



ed. In eastern Canada, however, ownership patterns, supply structure and forest management regulations make the supply much less elastic. Pulpwood price increases generally keep pace with rises in production costs (labor, energy, stumpage fees). Prices rarely fall or rise faster than general inflation.

Today, however, import/export opportunities are much more important, thanks to supply dislocations, changing resource-demand patterns and competitive transportation costs. Nearly every wood resource market in the world is affected—sometimes dramatically.

Three examples illustrate these impacts on prices:

- Portugal formerly controlled the price of pulpwood, and it was illegal to export pulpwood or wood chips. With controls removed during the '80s, Spain started buying cheaper Portuguese wood. Soon, Portuguese hardwood pulpwood prices zoomed 140%, while softwood's price doubled.
- Chile also prohibited exports until 1985. But when controls were abolished, a lack of loading and dock facilities limited exports. This created a two-tiered market, with export prices 200% above domestic prices. Nonetheless, the situation pulled up domestic pulpwood prices by nearly 50% since 1986.
- U.S. Pacific Northwest pulpwood prices show the increasing volatility of markets when partly driven by import/export opportunities. Fiber prices in Oregon and Washington are back to their early-'80s habits of extreme volatility. Since early 1988, softwood chip prices have risen 80% and hardwood chip prices are up nearly 40%.

Local prices can be influenced by import opportunities. Potential purchases of lower-cost imported fiber help hold down domestic prices.

Through the 1990s, regional pulpwood markets worldwide will be influenced by an increasing volume of international pulpwood sales. Although these shipments are economically inefficient, regional fiber shortages will cause them to continue.

Unless wood chip cartels spring up, the increased influence of import/export opportunities on regional pulpwood markets will make these markets more interrelated during the '90s. This, in turn, will increase the volatility of regional wood markets as they react unevenly to global market trends in pulp consumption, paper production and general economic health.

The next decade will bring little change to the list of importers of pulpwood. But major changes are projected on the supply side as the abundance of softwood from Chile, New Zealand and Australia elbows out some western U.S. and Canadian sales to the Far East.

Shortages of hardwood in the Pacific region have resulted in sales from the U.S. South to Asia. These exports are not likely to continue through the next decade as hardwood plantations in Chile, Malaysia and the Philippines come on stream.

In the Atlantic region, major changes in pulpwood suppliers are expected. Softwood from Portugal, Spain, Chile and Africa will be harder to get because of potential export restrictions, increasing domestic prices and shipping costs. Northern Germany's softwood surplus will be consumed locally, and unified European Community (EC) trade rules after 1992 will probably end most wood exports.

East Bloc countries will continue selling softwood, but not at bargain prices. Softwood-hungry Scandinavians will probably turn to eastern North America as the most obvious source. The pinewood nematode, which stopped this trade in 1985-86, may not always be an obstacle.

Hardwood trading patterns will probably remain as they are now during the 1990s. Pulp and paper producers' efforts to find fiber increasingly will influence corporate investment and management decisions.

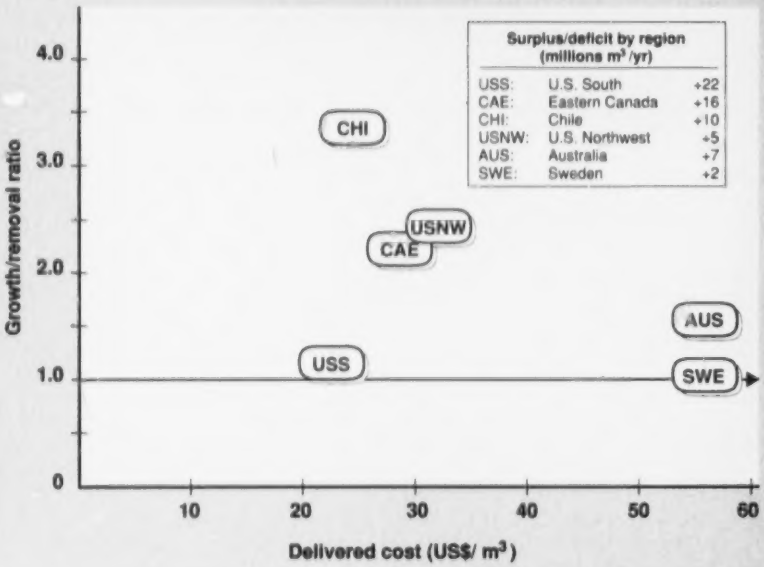
Companies will invest overseas to offset fiber dislocations. These investments might range from part-ownership of pulping plants to establishment of plantations. Japanese companies have so far led the trend toward locking in hardwood resources in the Pacific region. North American companies have started developing hardwood resources in the West's predominately softwood forests.

If the pinewood nematode problem in eastern North America can be solved, the U.S. South could become a major exporter of pulpwood and chips. Meanwhile, many offshore companies view the South as an attractive investment opportunity. The deregulated nature of the region's softwood resources, as well as current relative wood costs, create an attractive fiber package. Future expansions and ownership changes in this region are likely to have a distinct international flavor.

Many domestic fiber markets are likely to become unstable in the 1990s as they are drawn into volatile world markets. Impacts will not be the same in all regions, but fiber buyers in many areas will try to increase their control of raw material. Such strategies will cost money, and may make it harder for companies to expand or modernize their mills.

Clearly, the risk and effect of potentially volatile pulpwood markets on a company's operations and profitability must be reconsidered and weighed against the investment required to ensure a proper supply of raw materials. ■

FIG. 2—Hardwood fiber supply environments for selected regions



THE AUTHOR is president of Wood Resources International Ltd., Reston, Va., providing consulting services to the international forest products industry.

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